Annual Report / 1965

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UNITED WHELAN CORPORATION

United Whelan Corporation

EXECUTIVE AND GENERAL OFFICES:
1615 Northern Boulevard,
Manhasset, N. Y. 11030

Board of Directors

MARTIN S. ACKERMAN
LESTER B. SAMIT
CHARLES ZOHLMAN
DR. RICHARD SHELTON
WILLIAM G. HOBBS, JR.
ALAN S. SALNY
SAMUEL SHAPIRO

Officers

MARTIN S. ACKERMAN, *Chairman and President*
LAVERE G. LUND, *Vice President and General Manager*
ALVAH K. PARENT, *Vice President and Secretary*
HERMAN H. GOLDSTEIN, *Vice President*
CHARLES ZOHLMAN, *Vice President*
LESTER B. SAMIT, *Treasurer*

March 31, 1966

To Our Shareholders:

The 1965 fiscal year was a year of great change at Whelan. The Company had severe losses in both operations and disposition of assets, as the Brief Comparative Highlights section of the report indicates.

In July of last year, a corporation wholly owned by Martin S. Ackerman purchased approximately 20% of the Company's shares from certain of the then directors and their associates. Mr. Ackerman was elected Chairman of the Board of Directors and President of the Company in August. In November, Perfect Photo, Inc., a nationwide film processing company, acquired the aforesaid shares of the Company at cost, following the resignation of the former Board of Directors of the Company and the acquisition by the Company of an interest in Hudson National, Inc. which is referred to in greater detail later in this letter. The present directors of the Company were elected at various times subsequent to July; their names are set forth on the facing page of this Annual Report. Messrs. Ackerman, Samit, Salny and Zohlman are all directors of Perfect Photo, Inc. and Messrs. Ackerman and Samit are, respectively, its President and Chairman and Secretary-Treasurer.

The Company's new management has expended great efforts in its endeavor to improve results in future years. We have striven to utilize to the maximum the assets of the Company, and at the same time, to minimize the Company's activities in areas to which its competence does not extend.

Accordingly, substantially all of the assets of the Charles Stores Division were sold in the fall of 1965. The Charles Stores Division, comprising 23 conventional junior department stores and three one-stop discount centers, was a principal contributor to the Company's losses. This division necessitated substantial overhead expenses in an industry characterized by low profit margins. Moreover, the Company had insufficient experience and management expertise to maintain adequate control of its geographically dispersed operations.

Although the Company maintained extremely costly accounting and computer departments, the Company's budgetary and accounting systems were inadequate in the production of information required for management decisions. Modern budget accounting and computer systems which pin-point profit centers and make managers responsible for profits in their centers are being introduced. These systems will aid all levels of management in quickly determining the factors in each center which must be altered to produce maximum profitability.

The Company incurred heavy expenses in the start-up cost for the systems and for the Company's move to a modern central headquarters. Management is confident, however, that the ultimate saving in operating and overhead expenses will more than compensate for the initial expenditures.

The Whelan's Drug Store Division is being revitalized. Programs for cleaner stores, redecorated stores and remerchandised stores are well under way. They will offer better grades of merchandise, more attractively displayed, sold by more courteous and "sale-conscious" employees. Advertising expenditures are being stepped up. New stores will open in New York City and its suburbs. In short, Whelan's Drug Stores will be upgraded to cater to the consumers' taste for something better at an attractive but profit-yielding price.

In accordance with the policy of maximum utilization of the Company's assets, Whelan, in November 1965, purchased 61% of Hudson National, Inc. for approximately $4,900,000. Hudson whose stock is traded on the American Stock Exchange, distributes a full line of vitamins and sundries by mail and is a major factor in its industry. Hudson's products are being introduced into and will be aggressively sold by Whelan's Drug Stores.

Hudson in turn owns 69% of Equality Plastics Inc., a manufacturer, importer and distributor of plastics and novelty items, whose stock is traded in the over-the-counter market. Equality's products will also be distributed through Whelan's Drug Stores.

Perfect Photo, Inc. presently owns approximately 24% of the outstanding Common Stock of the Company. Perfect, whose stock is traded on the American Stock Exchange, services the expanded photo departments in Whelan's Drug Stores.

On February 12, 1966 the Company entered into agreements to acquire the assets of Perfect, Hudson and Equality in exchange for the Company's common stock. The terms of the proposed acquisitions will be fully described in the Company's proxy material for the forthcoming Annual Meeting. It is anticipated that the Annual Meeting of Shareholders will be held in June, 1966.

We wish to express our thanks to our shareholders and employees for their cooperation and confidence in the Company. With the continued aid, advice and cooperation of our shareholders, employees and friends, we are confident that Whelan will become a leader in its industry.

For the Board of Directors,

MARTIN S. ACKERMAN
Chairman and President

BRIEF COMPARATIVE HIGHLIGHTS

	Year ended	
	January 1, 1966	January 2, 1965
Sales and shipments to agents	$29,812,778	$43,716,565
Net (loss)	(3,541,916)	(552,262)
Special (charge) — provision for losses on leased properties	—	(1,300,000)
(Loss) per share	(2.87)	(0.46)
Special (charge) per share	—	(1.03)
Shares of Common Stock outstanding at end of year	1,240,302 shs.	1,257,915 shs.

United Whelan Corporation and Subsidiaries

Consolidated Balance Sheet

Assets

	January 1, 1966	January 2, 1965
CURRENT ASSETS:		
Cash	$ 4,449,863	$ 2,772,042
Accounts and notes receivable, less allowances for doubtul accounts of $185,223 and $320,571 respectively (Note 2)	1,157,795	1,986,100
Inventories at cost or market, whichever is lower	4,360,004	6,112,453
Prepaid expenses	194,343	179,533
	$10,162,005	$11,050,128
NOTES RECEIVABLE, due after one year (Note 2)	781,997	114,711
PROPERTY AND EQUIPMENT (Note 3)	2,803,978	2,860,561
EXCESS OF COST OVER NET TANGIBLE ASSETS ACQUIRED (Note 1)	3,274,823	—
OTHER ASSETS	165,275	142,914
	$17,188,078	$14,168,314

Liabilities and Shareholders' Equity

CURRENT LIABILITIES:		
Accounts payable	$ 3,205,363	$ 3,106,943
Accrued salaries and related items	433,176	364,307
Federal income taxes (Note 4)	437,225	49,902
Current portion of bank loans and other long-term debt	979,875	—
	$ 5,055,639	$ 3,521,152
BANK LOANS, due after one year (Note 5)	$ 3,000,000	$ —
5½% MORTGAGE, payable $12,000 annually with balance due 1969	117,000	—
DEFERRED CREDIT	—	36,560
OTHER LIABILITIES, due after one year	331,875	—
	$ 3,448,875	$ 36,560
RESERVE FOR LOSSES ON LEASED FACILITIES (Note 6)	$ 1,188,611	$ 1,300,000
MINORITY INTERESTS IN SUBSIDIARIES (Note 1)	$ 1,840,307	$ —
SHAREHOLDERS' EQUITY:		
Convertible $3.50 cumulative preferred stock, $100 par value; authorized 50,000 shares, 4,402 issued	$ 440,200	$ 440,200
Common stock, 30¢ par value; authorized 3,000,000 shares, 2,307,388 issued	692,216	692,216
Other capital paid in	6,361,411	6,361,411
Retained earnings (Notes 4 and 5)	3,585,708	7,142,501
	$11,079,535	$14,636,328
Less treasury stock, at cost – 242 shares and 20 shares convertible $3.50 cumulative preferred stock and 1,067,086 shares and 1,049,473 shares of common stock	5,424,889	5,325,726
	$ 5,654,646	$ 9,310,602
LONG-TERM LEASES AND CONTINGENT LIABILITIES (Notes 1, 4 and 7)		
	$17,188,078	$14,168,314

See notes to financial statements.

United Whelan Corporation and Subsidiaries

Consolidated Statement of Loss and Special Charge

	Year ended	
	January 1, 1966	January 2, 1965
Sales and shipments to agents – net (Note 8)	$29,812,778	$43,716,565
Costs and expenses:		
Cost of sales and cost of shipments to agents (including certain occupancy, warehousing and buying expenses), excluding depreciation	$23,069,571	$34,486,593
Selling, general and administrative expenses, excluding depreciation	8,932,585	9,364,543
Depreciation	482,478	573,476
Amortization of excess of equity in net assets of a consolidated subsidiary over investment therein	(36,560)	(125,400)
	$32,448,074	$44,299,212
Loss on operations	$(2,635,296)	$ (582,647)
Loss on disposition of assets (Note 9)	(811,853)	(112,395)
Loss before federal income tax	$(3,447,149)	$ (695,042)
Federal income tax (credit) (Note 4)	63,549	(142,780)
Net loss, including minority interests	$(3,510,698)	$ (552,262)
Minority interests in subsidiaries' profits	31,218	–
Net loss	$(3,541,916)	$ (552,262)
Special charge – provision for losses on leased properties not used for store operations (Note 6)	–	(1,300,000)
Net loss and special charge	$(3,541,916)	$(1,852,262)

See notes to financial statements.

Statement of Consolidated Retained Earnings

	Year ended January 1, 1966	Year ended January 2, 1965
Balance at beginning of year	$7,142,501	$9,019,986
Net loss and special charge for year	(3,541,916)	(1,852,262)
	$3,600,585	$7,167,724
Cash dividends on preferred stock ($3.50 per share)	14,877	25,223
Balance at end of year	$3,585,708	$7,142,501

Notes to Financial Statements

NOTE 1 — ACQUISITION OF HUDSON NATIONAL, INC. AND SUBSIDIARIES:

In November, 1965, a wholly-owned subsidiary of Whelan purchased 61% of the outstanding common stock of Hudson National, Inc. for approximately $4,900,000. The financial statements include the operations of Hudson (and its 69%-owned subsidiary, Equality Plastics, Inc.) from the date of acquisition. The purchase price exceeded the net tangible assets acquired by $2,977,948 which is classified in the balance sheet as "Excess of cost over net tangible assets acquired".

Prior to the acquisition of the Hudson stock by Whelan, Hudson had a contract with each of three drug stores owned by some of its then officers and directors which prevented Hudson from selling vitamins, drug and similarly related products in retail stores in the New York City metropolitan area. Simultaneously with the acquisition of the Hudson stock, Whelan, Hudson and the three drug stores amended the contracts to permit Hudson to sell such products anywhere, with only minor exceptions. The amendment to one contract provides that Whelan pay one store $296,875 over twenty years. In addition, Whelan is to pay that store each year for 20 years, 25% of the amount by which the store's purchases of Hudson products falls below $100,000. (This amount is about one-half of the present annual purchases from Hudson.) The amendments relating to the other two stores provide that Whelan pay to the stores each year for 20 years, 25% of the amount by which the purchases of Hudson products by each store falls below $150,000 and $60,000 respectively. Such amounts are approximately the present level of such annual purchases.

The payments to be made under these amendments are considered to be additional cost of the Hudson stock, and accordingly the fixed payments of $296,875 are recorded as "Excess of cost over net tangible assets acquired." The contingent payments are to be similarly recorded, when and if paid.

NOTE 2 — ACCOUNTS AND NOTES RECEIVABLE:	January 1, 1966
Notes due from Volume Merchandise, Inc. pledged as collateral for bank loans (Note 5)	$1,092,270
Other notes receivable	112,641
	$1,204,911
Portion due after one year	781,997
	$ 422,914
Accounts receivable, including agencies	657,994
Other accounts receivable	262,110
	$1,343,018
Allowance for uncollectible amounts	185,223
	$1,157,795

NOTE 3 — PROPERTY AND EQUIPMENT, at cost:

	January 1, 1966	January 2, 1965
Land	$ 251,349	$ 17,317
Buildings and building improvements	717,355	97,282
Machinery, furniture and fixtures	2,964,180	4,613,297
Leasehold improvements	1,492,406	1,072,145
	$5,425,290	$5,800,041
Less accumulated depreciation and amortization	2,621,312	2,939,480
	$2,803,978	$2,860,561

NOTE 4 — TAXES:

The Company is protesting the Internal Revenue Service's proposed disallowance of deductions taken in the Company's 1959, 1960 and 1961 consolidated federal income tax returns for post-acquisition losses of Crawford Clothes, Inc. ("Crawford"), a former subsidiary. The proposed disallowance is based upon the contention of the Internal Revenue Service that the principal purpose of the acquisition of Crawford was tax evasion or avoidance. It is the opinion of the Company's counsel, based upon their discussions of the facts surrounding the acquisition with various officers and directors of the Company, and upon their examination of relevant documents and records made available to them, that tax evasion or avoidance was not the principal purpose of the acquisition and that the Company should be entitled to the deduction of the subsidiary's losses in such consolidated returns. Accordingly, no provision for the proposed tax deficiency (approximately $2,000,000), or interest thereon, has been made in the accompanying financial statements.

NOTE 5 — LONG-TERM BANK LOANS:

The 6% three-year loan agreements, payable $333,333 quarterly starting June 1, 1966, contain, among other matters, the following provisions:

(a) The Corporation shall maintain consolidated working capital of $4,500,000 and consolidated net worth of $5,500,000.

(b) The Corporation shall apply in prepayment of the loans all cash distributions on the stock of Hudson National, Inc. and all proceeds from the sale of five or more stores in any one year.

(c) The Corporation may not acquire property or equipment (as defined) in any one year in excess of $300,000.

(d) The Corporation may not pay dividends or acquire equity investments which, combined would exceed fifty per cent of its net income after December 31, 1965.

(e) The Corporation's ability to borrow, make loans, acquire businesses, sell property, etc. is restricted.

Notes of $1,092,270 received in connection with the sale of the Charles stores are pledged under these loans. In addition, the banks may obtain, on demand, a security interest in and lien on all of the Corporation's property and equipment, accounts receivable, inventory and any investment securities other than equity securities.

NOTE 6 — RESERVE FOR LOSSES ON LEASED FACILITIES:

During the year ended January 2, 1965, the Corporation made a provision of $1,300,000 (charged as a special item in the accompanying consolidated statement of loss and special charge) for estimated future losses applicable to leases on locations

where operations had been discontinued, to the extent circumstances did not indicate a recovery of such losses through sub-rentals or a store expansion program as to which there were no immediate plans. In fiscal 1965, $111,389 of such losses applicable to the above leases was charged to the reserve.

NOTE 7 — CONTINGENT LIABILITIES AND COMMITMENTS:

The Company and its subsidiaries, which lease substantially all store properties, have 60 leases on real property expiring at various dates to 1990 with minimum annual rentals of $1,031,000. Total rentals for 1965 were $1,243,000 under these leases. The majority of the leases provide for additional rentals based upon percentages of sales in excess of predetermined bases and upon other factors. Under these leases the annual minimum rentals, by five-year periods, are approximately as follows:

1966-1970	$1,006,000
1971-1975	460,000
1976-1980	316,000
After 1980	153,000

The above leases are exclusive of those applicable to stores sold or closed for which the rentals have been provided as described in Note 6.

NOTE 8 — AGENCY AGREEMENTS:

In July, 1965, the Company terminated all agency agreements. New agreements were then signed with approximately 135 of those independently owned drug and cigar stores to whom the Company is continuing to sell merchandise. Under the new agreements the stores pay the Company a monthly fee which is included in sales.

NOTE 9 — LOSS ON DISPOSITION OF ASSETS:

During fiscal 1965, the Corporation disposed of various assets including all but one of the stores of its Charles division. The sale of the Charles stores in September, 1965 for $1,350,665 in cash and $1,156,521 of notes resulted in a loss of approximately $780,000.

NOTE 10 — MANAGEMENT FEES:

In August, 1965, management engaged approximately 30 officers and employees of Perfect Photo, Inc. (which acquired 24% of the outstanding stock of Whelan in November, 1965) to render general management and accounting services including analyses of the Corporation's accounting and marketing procedures. The Board of Directors of Whelan agreed to pay Perfect for the officers' and employees' time expended on behalf of Whelan, plus 40% for overhead. The charge for these services was $181,000 to the year-end. The above arrangement was terminated as of January 1, 1966 and certain officers and employees of Perfect began to work for Whelan on a part-time basis.

NOTE 11 — PRIOR YEAR'S STATEMENTS:

The special charge of $1,300,000 (Note 6) was shown as a direct charge to retained earnings in last year's annual report to stockholders. In addition, certain other items in the 1964 annual report were reclassified to be consistent with this year's presentation. The statements for the prior year had been examined by other independent certified public accountants.

NOTE 12 — POST BALANCE SHEET EVENT:

In February, 1966, the Corporation agreed, subject to approval of the stockholders, to acquire the assets of Perfect Photo, Inc., and the minority interests of Hudson National, Inc. and Equality Plastics, Inc. in exchange for Whelan stock. In addition, the Board of Directors has proposed a reverse split of four-for-one for the Corporation's common stock.

Accountants' Report

Board of Directors,
United Whelan Corporation,
New York, N. Y.

We have examined the accompanying consolidated balance sheet of United Whelan Corporation and subsidiaries as of January 1, 1966 and the related statements of loss and of retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, subject to the outcome of the income tax matter referred to in Note 4, the financial statements referred to above present fairly the consolidated financial position of United Whelan Corporation and subsidiaries at January 1, 1966, and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

TOUCHE, ROSS, BAILEY & SMART
Certified Public Accountants

New York, N. Y.
March 29, 1966

General Counsel

COOPER, OSTRIN, DeVARCO & ACKERMAN, New York, N.Y.

Transfer Agent

Convertible Preferred Stock and Common Stock
The Marine Midland Trust Company of New York, N.Y.

Registrar

Convertible Preferred Stock and Common Stock
Chemical Bank New York Trust Company, New York, N.Y.